DOCUMENT RESUME

ED 331 370 HE 024 426

AUTHOR Garg, Ramesh C.
TITLE Latin American Debt: Opportunities for Universities.
PUB DATE 90
NOTE 12p.
PUB TYPE Viewpoints (Opinion/Position Papers, Essays, etc.) (120)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS *Developing Nations; *Educational Finance; Foreign Countries; Higher Education; *Institutional Cooperation; International Cooperation; *International Programs; Investment; Loan Default; *Loan Repayment; Universities
IDENTIFIERS *Latin America

ABSTRACT

The debt crisis of the lesser developed countries (LDCs) may provide opportunities for educational institutions. Through debt-for-education programs, a part of the huge debt load can be channelled into financing various educational programs sponsored by U.S. higher education institutions. Private commercial banks and multinational corporations are the two major available sources of acquiring debt or local currency which can be used to finance various educational programs. U.S. educational institutions desirous of acquiring local currency from foreign debt or blocked funds to support educational programs in debtor countries may do so through purchasing debt in secondary markets, through debt-for-equity swaps, or debt donations. In fact, some commercial banks involved in debt-for-equity conversion programs may be willing to either sell or donate part of their Latin American debt to universities. For the program to be successful, it must be mutually beneficial to the lending banks, the debtor countries, and universities. Universities may be the major beneficiaries of debt for education programs since access to cheaper local currencies would enable them to extend their limited resources to develop international programs in various fields including faculty business, languages, culture, and international student exchange. Includes four references. (LPT)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED331370

LATIN AMERICAN DEBT: OPPORTUNITIES FOR UNIVERSITIES

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

☐ This document has been reproduced as received from the person or organization originating it.

☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL HAS BEEN GRANTED BY

Ramesh C. Garg

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

Dr. Ramesh C. Garg
Professor of Finance and International Business
Department of Accounting and Finance
Eastern Michigan University
Ypsilanti, Michigan 48197

HE 024 426

LATIN AMERICAN DEBT: OPPORTUNITIES FOR UNIVERSITIES

The international debt crisis is heating up again with the prices for several developing country loans falling to their lowest levels in recent history. The debt of some big Latin American countries is changing hands for as low as 20 cents on the dollar in the secondary market, with very few buyers in sight (see Table 1). Brazil, the biggest debtor nation, recently suspended its debt-for-equity swaps. It is also believed that Argentina may suspend its debt-for-equity auctions soon. Under the debt-for-equity swaps, a creditor exchanges foreign loans at a discount for local currency at the debtor nation's central bank.

The purpose of this paper is to investigate opportunities for debt-for-education swaps. The debt crisis of LDCs may afterall turn out to be an opportunity for educational and not-for-profit organizations. Under this program, a part of the huge debt load can be channelled into financing various educational programs sponsored by U.S. universities and colleges. For any such program to be successful, it must be mutually beneficial to all the parties involved in the transaction; viz., the lending banks, the debtor nations, and the universities.

Logistics of a Debt-for-Education Swap Program:

1. Sources of Debt

There are two primary sources of acquiring debt or local currency which can be used to finance various educational

programs:

A. Private Commercial Banks

With increased possibilities of defaults by many LDCs on their external loans, many of the money center and regional banks are anxious to unload their large and shaky third-world loans. Historically, a number of Latin American countries and lender banks have resorted to the process of debt restructuring as a means to resolve the problem. However, this process of debt renegotiation has not worked. In fact, debt reschedulings have merely postponed the crisis; it is a short-term solution to a long-term problem. With increased pressure from their external auditors, many banks are constantly adding more reserves to their foreign loan portfolios. In addition, the banks are trying to sell their LDC loans in the secondary market at substantial discounts (see Table 1). A bank may also wish to relinquish its LDC debt in order to escape involuntary participation in future loan rescheduling agreements. Under the debt rescheduling terms, the bank might be required to re-lend to a country as a part of new loan packages in proportion to the bank's share of total outstanding loans to that country.

B. Multinational Corporations:

Many multinational corporation (MNCs) derive their revenues in local currencies in many Third-World countries. Due to various limitations and restrictions on repatriation of profit and principal amounts, many MNCs find themselves with blocked funds in LDCs. These blocked funds become an

important source of obtaining local currencies for an outside agency that wishes to pursue its educational activities in the host country.

2. Mechanisms of Utilizing Debt for Education Programs:

There seem to be three options available to a U.S. educational institution that wishes to acquire local currency from foreign debt or one with blocked funds to support its various programs in the host country:

A. Purchasing Debt in Secondary Markets:

Under this option, the educational institution will use its own hard currency to purchase debt from a bank or MNC at a substantial discount. This debt can then be redeemed in local currency at par at the debtor nation's central bank; thus reducing the cost of acquiring local currency. The proceeds (in the local currency) can be used to support educational programs. With prior negotiations, it might be possible to obtain a better exchange rate from the host country if the educational project purported to be financed is deemed mutually beneficial.

B. Debt Donation:

In some instances, private commercial banks may, in fact, choose to outright donate part of their LDC debt asset to an educational institution. There are several advantages to the banks in doing so. Banks may be motivated to donate their external debt holdings partly because of the "public relations" value associated with such donations. Since most of these debts are already selling at substantial discounts

and the buyers are few; the real cost of such donations may be minimal to the bank. A study prepared by the U.S. Department of Commerce highlights the tax merits of issues associated with outright donations by commercial banks vis-a-vis selling of debt in the secondary markets.[1] According to the study, the Internal Revenue Service (see Ruling: Rev. Rul. 87-124, issued in November 1987), increased the incentive to donate the debt. By donating, a bank can receive a tax deduction of the full face value of its loan rather than on the loan's "fair market value" only. Prior to this ruling, deductions were limited to the "fair market value" of a loan, i.e., on the discounted market price at which the loan could be sold in the secondary markets. Ruling 87-124, in effect, made it possible for a bank to sell its external loan to the host central bank; exchange it for local currency; claim a tax deductible loss on the difference between the face value of the loan and the dollar value of the local currency received for it; contribute the local currency to a U.S. not-for-profit organization; and claim a tax deduction on the contribution. In other words, the donated amount of the loan can be completely written-off for tax purposes.

Most educational institutions might find the "donation" route to be the most attractive in meeting their needs and should pursue regional banks which have exposure to such loans. While banks may still find the "selling" of debt to be the preferable option, they might not be entirely averse

to the idea of donating the debt. The thought of gaining public goodwill, lack of secondary markets for its debt and some special tax incentives which might be available can make a convincing case for donation of debt by a bank to an educational institution.

C. Debt for Equity Swap:

Under this option, an educational institution can link up with a U.S. multinational corporation which is involved in a debt-equity swap. The following example cited by the U.S. Department of Commerce study highlights the mechanics of such an arrangement:[2]

Example: U.S. firm F has bought a $1,000,000 loan to Country X from a U.S. bank. F now negotiates to exchange the $1,000,000 loan for 8,000,000 pesos that it will invest in an enterprise in Country X. At this point, University U, which wants to build a 1,000,000 peso language training center in country X that Country X fully approves of, approaches F. It informs F that U can arrange for F to receive 9,000,000 instead of 8,000,000 pesos for the $1,000,000 loan. F agrees to this arrangement. If F will donate 1,000,000 peso to U and provide U's project with certain services, all parties benefit. U gets the money to build the language training center. X gets the benefit of the center. And F gets a tax deduction on its 1,000,000 peso contribution to U that presumably exceeds the value of the services it will provide U.

Progress-to-Date:

Several steps have already been taken to promote the idea of using debt for development programs. Debt for Nature Swaps has already been initiated by several of the environmental and conservation groups and already implemented in a few Latin American countries such as Costa Rica and Bolivia. Bolivia, for example, agreed to allow Conservation International (CI), a Washington-based nonprofit group, to swap $650,000 of its deeply discounted debt from a Swiss Bank for about $100,000. In return, the government allowed CI to create a jungle preserve to develop some environmentally precious region.[3]

The National Association of State Universities and Land-Grant Colleges (NASULGC) Division of International Affairs has established a University Debt For Development Task Force to monitor opportunities and facilitate the formulation of programs. The Task Force, which includes representatives from the Association of American Universities (AAU) and the American Council on Educational (ACE), is chaired by Dr. Elwin Svenson, Vice Chancellor, University of California, Los Angeles.[4] The University Debt for Development Task Force is currently establishing University Country Committees. The purpose of these committees is to develop a strategy which would include the broad interests of educational institutions within the Debt for Development Coalition so that higher education can benefit from the new initiatives in the debt structuring process.

Conclusion:

The notion of swapping debt-for-education seems to have a lot of merit from the viewpoints of all the parties involved in such a transaction. The big U.S. banks are now anxious, willing, and able to reduce their loan exposures to Latin American countries. They already have accumulated sizable, albeit inadequate, reserves to ward off any financial crisis. Nonetheless, because of these non-performing loans, the stock prices of several major New York banks such as Chemical Banking Corp. and Manufacture Hanover Corp. languish well below book value and often trade at the historically lower multiples of their annual earnings. Many of these banks are increasingly participating in debt-for-equity conversion programs. However, these banks are limited by the U.S. Federal Reserve Board to undertake only passive minority stakes in foreign non-financial businesses, and only a few banks have the local offices and expertise to make such investments. As an alternative to debt-for-equity swaps, some of these commercial banks may be willing (or could be persuaded) to either donate or sell part of their Latin American debt to universities. By reducing exposure to these loans, bank stocks may be favorably impacted in their market valuations.

From the Debtor Countries' perspective, swapping of debt for "social good" purposes can hardly be disputed. Many debt-troubled Latin American countries have been slow to

embrace private debt-for-equity conversions because of their fear that these programs might add fuel to their already existing inflationary spiral. Debtor countries also worry that the private debt-equity swaps allow major companies to fall into foreign hands. It seems that these countries would be more willing to entertain programs channelled through nonprofit organizations; including educational institutions. The debtor countries might be willing to allow more favorable exchange rates for educational programs.

From the Universities' perspective, they might be the major beneficiaries of debt-for-education programs. Having access to cheaper local currencies, universities can extend their limited resources to build up their international programs in the fields of languages, art, culture, business etc. including faculty and student exchanges.

TABLE - 1

FALLING MARKET PRICES for DEVELOPING COUNTRY DEBT
(as a percentage of face value)

COUNTRY	JULY 85	JAN. 86	JAN. 87	JAN. 88	1/12/89	1/20/89
Argentina	60-65%	62-66%	63-65%	30-33%	21-22%	18-19%
Brazil	75-81	75-81	74-76.5	44-47	38-40	34-35
Chile	65-69	65-69	65-68	60-63	58-60	60-61
Mexico	80-82	69-73	54-57	50-52	40-41	38-39
Peru	45-50	25-30	16-19	2-7	5-8	5-8
Venezuela	81-83	80-82	72-74	55-57	38-39	37-38

Source: Shearson Lehman Hutton Inc.

END NOTES

1. Czinkota, Michael R. & Martin J. Kohn, 1988. Improving U.S. Competitiveness: Swapping Debt for Education, U.S. Department of Commerce, International Trade Administration, A Report to the Secretary of Commerce.

2. Ibid., pp. 10-11.

3. Peter Truell, "What Monkeys in Bolivia Have to Do With the Debt Crisis," Wall Street Journal, January 20, 1988, p.1.

4. Elwin Svenson, "Debt for Development: A Report from the University Debt for Development Task Force," Working Paper, October 18, 1988 .